EXITS AND THE EFFECT ON ENTREPRENEURIAL RECYCLING

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ABSTRACT

We examine the nature of entrepreneurial exit and its impact on the intentions for subsequent recycling activities. We categorize the self-determined reason for exit and track entrepreneurs’ intentions to subsequently re-engage in entrepreneurship based on six types of recycling activities. We find that entrepreneurs with a positive exit (such as harvest) are more passionate about entrepreneurship, more likely to invest in other ventures and more likely to be involved in entrepreneurial recycling. Those that exited for family reasons or other opportunities were significantly less likely to be involved in a new venture. We discuss these and other findings.

INTRODUCTION

The concept of entrepreneurial churning – the ongoing, iterative process of new ventures entering, and other firms exiting, the economy – is fundamental to the concept of entrepreneurship (Kerr & Nanda, 2009; Schumpeter, 1934; Spinelli, Neck, & Timmons, 2006). New firms continually enter and exit the market. For example the Bureau of Labor Statistics (BLS) reports that in the United States, over the past 10 years (Jan 2004-Dec 2013), approximately 8.5 million firms were created while 7.84 million firms left the market. One core assumption perpetuated by strategy and organization scholars has been that the goal of the firm is to achieve sustainable competitive advantage and organizational effectiveness and the death (or exit) of a firm is something to be avoided. “Many studies use the notion of organizational death as an indicator of ‘fit or misfit’ within a particular domain, with important consequences for the analysis of business firms, industrial arenas, and national economies” (Bahrami & Evans, 1996, p. 63).

Others, and entrepreneurship scholars in particular, refute the assumption that the goal of the firm is to exist into perpetuity. Rather, they argue that churning is an important component of the entrepreneurial process and critical to develop an entrepreneurial ecosystem (Bahrami & Evans, 1996; Kerr & Nanda, 2009). Entrepreneurship scholars suggest that exit may not result in negative consequences, and in fact, may result in entrepreneurial recycling (Bahrami & Evans, 1996; Hessels et al., 2010; Mason & Harrison, 2006) – wherein “successful cashed out entrepreneurs reinvest their time, money and expertise in supporting new entrepreneurial activity” (Mason & Brown, 2014; 1). In other words, rather than viewing firm exit as a universal negative, both successful and “failed” ventures can result in new venture creation, new venture funding (through angel and venture capital), and ongoing mentorship and advisers (Mason & Brown, 2014). In addition “failed” ventures can boost the economy and the entrepreneurial ecosystem by releasing underutilized resources (e.g. people or knowledge) back into the ecosystem.

Two literatures have examined the entrepreneur after the exit and the bulk of this research has focused upon serial entrepreneurs (Westhead & Wright, 1998) and re-entry (Ucbasaran, Westhead, Wright & Cotton, 2010). For example, Hsu, Wiklund and Cotton (forthcoming)
find that success or failure of prior entrepreneurial experiences influences the attractiveness of re-entry. Hessels et al., (2010) analyzed the Global Entrepreneurship Monitor (GEM) data from 24 countries from 2004-2006 (350,000 observations) and found that a recent exit “substantially increases the probabilities of being involved in 5 engagement levels (potential, intentional, nascent, young, and established entrepreneurship). Entrepreneurial recycling also addresses this issue but in a broader sense because recycling includes re-entry. In her research following the 12 year history of ImmuLogic, Packalen (2014) finds that entrepreneurial recycling occurs in the founder's wealth, the company patents, and former employees. These resources were reinvested in the economy in a way that might provide an overall gain to the economy. In their research into Canadian manufacturing enterprises Pe’er and Vertinsky (2008, p. 281) find that exits of both older incumbents and younger firms contribute to increases in entry and propose that these findings lead to important policy implications such that “...the exit and turnover of firms may have positive economic welfare benefits that could be lost by shoring up failing companies....”

In this research we further examine the question of entrepreneurial recycling and specifically explore whether the motivation for exit affects entrepreneurial recycling. We specifically address two research questions: (1) to what extent do exited entrepreneurs become involved and/or intend to become involved in entrepreneurial recycling, and (2) does the reason given for exit impact the type of recycling activity entrepreneurs choose? In addressing these questions, we offer three main contributions to the literature. First, there is relatively limited work that addresses this issue of recycling and we shed new light into that area. Second, we adopt a perspective of entrepreneurial recycling that is broader than what has been done in the literature. We examine six different types of re-engagement in recycling activities: 1) passion for future entrepreneurial activity, 2) current involvement in the creation of another business, 3) the likelihood of being involved in the creation of a business in the next year, 4) likelihood of involvement as an investor (Angel, VC), 5) serving as a mentor for another business, and 6) sitting on the BOD for another business. Third, we find differential engagement based upon the reasons for exit. Finally we embrace the literature that treats entrepreneurial exit as separate from entrepreneurial failure. In doing so, we look at a plethora of reasons underlying exit. This helps to contribute a broader viewer of exit, as well as its implications for the future.

**HYPOTHESES**

Our hypotheses are centered around the motivations for exit suggesting that those who exited due to poor performance are likely to have a lower passion for entrepreneurship and will be less likely to be involved in the creation of a new venture while those who exited to harvest (recapture their investment) will be more passionate about entrepreneurship and more likely to be involved in helping others create a ventures (i.e. provide venture funding, serve as mentors or board of advisors [BOD]).

However rather than an over simplistic focus on the entrepreneur's financial outcome as a predictor of churn, we hypothesize that those exiting due to “firm” factors (competitor's actions or internal firm issues) will be passionate about entrepreneurship, have a high likelihood of being involved in the creation of a business, and are likely to be involved in serving as mentors or on a board of directors (BOD). In other words, we argue that those with external focus on the explanation for firm exit were likely to have a subsequently positive impact on the ecosystem.
Further, those who exit for personal reasons (family, to take advantage of another opportunity, or for retirement) will be passionate about entrepreneurship, but less likely to be involved in any further entrepreneurial activity.

**METHOD**

We utilize the Kauffman Firm Survey (KFS) and the Kauffman Closed Business Survey (KCBS) to test our hypotheses. The KFS dataset is a panel study of new businesses founded in 2004 and tracked annually for the first eight years. It provides a unique opportunity to study new businesses from startup to exit and is the longest longitudinal survey of new businesses in the world. We used the KFS to identify founders who had closed their business prior to 2011 and conducted a follow-up survey with 102 exited founders. While this is a seemingly small sample size, it is important to note that many founders that exit are difficult to track, and, if found, are hesitant to discuss their experiences. In other words, this sample size is notable given the focus of the research. The mean firm age at time of exit was 5.61 years with 16% exiting within the first three years and 12% in year four, 14% in year 5, 17% in year 6, 25% in year 7, and 16% in year 8.

Our main dependent variable is entrepreneurial recycling activities and future intentions. This consists of 6 different potential current activities and future intentions. They are: 1) passion for future entrepreneurial activity, 2) current involvement in the creation of another business, 3) the likelihood of being involved in the creation of a business in the next year, 4) likelihood of involvement as an investor (Angel, VC), 5) serving as a mentor for another business, and 6) sitting on the BOD for another business. These six were established by drawing upon the current literature. Hessels et al. (2010) identify 5 stages of potential entrepreneurial activity: potential entrepreneur (has the knowledge, skills, and experience and thinks there will be good opportunities in the next six months), intentional entrepreneurs (expects to be starting a new firm within the next 3 years), nascent entrepreneur (actively setting up a business), young business owner, and established business owner. Mason and Harrison (2006) also finds that exited entrepreneurs go on to undertake other entrepreneurial activities including new venture creation, investment in other businesses as business angels or venture capitalists, and mentoring and advising. Our six dependent variables stem from these studies.

Our independent variables are reasons for exit. These too draw upon the literature (DeTienne, 2010; DeTienne, McKelvie, & Chandler, 2014; Harada, 2007; Hessels, et al., 2011; Packalen, 2014; Ryan and Power, 2012; Soleimanof, Morris, and Syed, 2014; Taylor, 1999; Wennberg et al. 2010; Wennberg and DeTienne, 2016). Based on these studies, we were able to develop a list of 30 potential reasons why entrepreneurs exit. An example of items include: “to start a new business”, “because of increased competition”, “to take a new job/enter employment”, and “due to poor financial performance”. We tested these reasons using a focus group of exited entrepreneurs in the summer of 2014. Our survey respondents were asked: Below is a list of reasons why people close or exit businesses they operate. Please indicate how much you agree or disagree with the following statements regarding the closure of [name of their business]. To assist with survey fatigue, these were broken into two sections in the survey.

We used exploratory factor analysis (EFA) to begin to classify these reasons for exit. EFA is particularly appropriate for scale development or when there is little theoretical basis for specifying a priori the number and patterns of common factors (Hayton, Allen & Scarpello, 2004: Hurley et al., 1997). Using principal component analysis (with varimax rotation), the criterion of retaining factors with eigenvalues greater than 1 (Kaiser, 1960), and examination of the scree plot (Hayton
et al., 2004), we identified seven major factors (or categories of reasons) for exit. These factors account for 65% of the variance and the eigenvalues range from 7.60 to 1.18. We then ran reliability statistics examining the Cronbach’s Alpha for each scale. In parentheses we provide the number of items retained and the Cronbach’s Alpha for each scale: (1) exit due to poor firm performance (4 item scale, a=.84), (2) exit due to harvest or recapture investment (4 item scale, a=.79), (3) exit due to competitor's actions (4 item scale, a=.74), (4) exit for family reasons or to take advantage of another opportunity (e.g. school or job) (5 item scale, a=.71), (5) exit to start a different venture (2 item scale, a=.91), (6) exit due to internal firm issues (e.g. employees, suppliers) (2 item scale, a=.73), and (7) exit for retirement (2 item scale, a=.67). Essentially we retained 22 of the 30 items; all those eliminated had too high cross-loadings or were part of a factor with a low Cronbach’s alpha.

RESULTS

As hypothesized, those that exited due to poor firm performance are significantly less likely to be involved in a new venture; however, they did not appear to be negatively passionate about entrepreneurship. Those that harvested were significantly more passionate about entrepreneurship, more likely to invest in other ventures, more likely to be a mentor, and more likely to sit on the BOD. They were less likely to be involved in a new venture that has achieved its first sale. Those that exited because of were significantly more passionate about entrepreneurship and more likely to serve as a mentor. Those that exited for family reasons or other opportunities were significantly less likely to be involved in a new venture. As expected, those that exited to start a different business were significantly more likely to intend to start a new business in the next year, were more likely to be involved in the creation of a new venture, and more likely to currently own a different venture. Those that exited to retire are significantly more likely to be passionate and to sit on a board of directors. They are significantly less likely to be currently involved in the creation of a new venture.

DISCUSSION

This research begins to develop and provide a better understanding of the reasons for exit beyond rudimentary positive or negative exit. It provides additional detail and specifics that are generally not addressed in the literature, such as exit for personal reasons or exit to pursue new ideas. This research may lead to new theoretical development about the positives of exit – whereas the literature has tended to focus on the negatives, including from an economic, psychological, emotional perspective.

This research also addresses the notion of exit and what it really means for the entrepreneur and for the entrepreneurial ecosystem. Churn is oftentimes described at the macro level – and viewed as important – and we help to bring this to the micro level, to understand the role of the individual entrepreneur and his/her exit for the implications of others.

The fact that there are statistically significant results based on these categories, despite relatively small sample size, illustrates an opportunity for the research to embrace wider definitions and reasons behind entrepreneurial exit… especially that which equates exit with failure (Wennberg & DeTienne, 2016; Jenkins & McKelvie, 2016).

Finally the limited exit research that examines subsequent implications generally involves starting another venture (see Jenkins). However, there are multiple ways to help engage an entrepreneurial ecosystem – and our six factor approach captures this. Notable anecdotal evidence
of this being the case, such as Reid Hoffman of LinkedIn acting as a super angel and thereby a
tremendously influential funder of other tech startups.

Overall, these findings have important implications for policy makers, educators and scholars. Of note is that theorizing about entrepreneurial exit needs to more fully embrace the multitude of reasons behind exit, rather than simply failure – and with a multitude of potential internal and personal reasons. Many firms are founded for personal – rather than economic - reasons, but the exit of firms has generally been treated as an economic decision rather than a personal one.

Limitations of this study include a small sample size and the potential for retrospective and attribution bias. We believe retrospective bias is somewhat attenuated because this is a major event in both the life of the firm and the entrepreneur thus it is a salient issue. We believe that attribution bias is somewhat reduced due to the fact that the entrepreneurs were part of a larger sample and would have very little reason to attribute their exit to something different; however, we cannot rule out this possibility.

In conclusion we find that entrepreneurs exit their ventures for a multitude of reasons many of which have little to do with firm performance. We found that they exit for exit due to desire to harvest or recapture investment, exit due to market factors (competition, regulation), exit for family reasons (children, household role) or to take advantage of another opportunity (e.g. school or job), exit to start a different venture, exit due to internal firm issues (e.g. employees, suppliers), and exit for retirement. This indicates that we have likely overstated failure rates when many of these reasons have little to do with failure. However, further research should examine these reasons controlling for firm performance because it is possible that some of the reasons given (market factors) really result in lower firm performance.

We also find that entrepreneurs have varying levels of re-engagement (recycling) after the exit. The reason for exit is directly linked to the types of recycling activities one engages in (starting a new venture, passion for entrepreneurship, funding new ventures, mentoring and advising new ventures). These results are the first to link reason for exit to recycling activities.

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